FORsights™

Advisers Face Sweeping New SEC & FinCEN Customer Rules

Under two recently issued proposals, certain registered SEC investor advisers (RIAs) and exempt reporting advisers (ERAs) would now be subject to Anti-Money Laundering and Countering the Financing of Terrorism (AML/CFT) provisions of the *Bank Secrecy Act* (BSA) and also be required to develop a customer identification program (CIP).

Background

BSA regulations were first enacted in 1970 with administration and enforcement duties delegated to the director of the U.S. Department of the Treasury's Financial Crimes Enforcement Network (FinCEN). The BSA was designed "to combat money laundering, the financing of terrorism, and other illicit financial activity, and to safeguard the national security of the United States."

The 2001 *USA Patriot Act* added CIP requirements covering all "financial institutions." This term is defined broadly and to date has applied to commercial banks; agencies, and branches of foreign banks in the United States; thrift institutions, credit unions, and private bankers; trust companies; SEC-registered securities brokers and dealers; investment companies; futures commission merchants; insurance companies; travel agencies; pawnbrokers; dealers in precious metals, stones, and jewels; check-cashers; certain casinos; and telegraph companies, among others.

On February 1, 2024, Treasury issued its 2024 Investment Adviser Risk Assessment**,** which noted that assets managed by advisers now significantly exceed the holdings of U.S. banks but are not uniformly subject to AML/CFT regulations.[1] The report concludes that due to the lack of comprehensive AML/CFT requirements for investment advisers, there is a material risk that investment advisers could be misused for illicit finance.

FinCEN has made multiple attempts to close this gap starting in 2002 and most recently in 2015 with a proposal that would have mandated the AML program, suspicious activity report (SAR) filings, a CIP requirement, and an obligation to collect beneficial ownership information for legal entity customers for RIAs. FinCEN and the SEC are trying again with two separate proposals leveraging the Treasury reports' material risk findings.

> "The proposed rule is designed to make it more difficult to use false identities to establish customer relationships with investment advisers," said SEC Chair **Gary Gensler**. "I support this proposal because it could reduce the risk of terrorists and other criminals accessing U.S. financial markets to launder money, finance terrorism, or move funds for other illicit purposes."

BSA Scope Expansion

On February 15, 2024, FinCEN issued a proposal that would require certain investment advisers to apply BSA requirements by adding the following to the list of businesses classified as "financial institutions":

[1]Some investment advisers may perform certain AML/CFT functions if the entity also is a registered broker-dealer, *i.e.*, a dual registrant, is a bank, or is an operating subsidiary of a bank; other investment advisers are affiliates of banks or broker-dealers, which may implement an enterprise-wide AML/CFT program that would include that investment adviser. In addition, some investment advisers may perform certain AML/CFT functions through contractual obligations for a joint customer of another financial institution subject to the BSA.

- Investment advisers registered with the SEC, also known as RIAs[2]
- Investment advisers that report to the SEC as ERAs[3]

The proposal would apply to non-U.S. RIAs and ERAs, even if they do not maintain any offices or personnel in the United States.

Obligations under the proposal include:

- Development and implementation of a written AML/CFT program that is risk-based and reasonably designed to prevent the investment adviser from being used for money laundering, terrorist financing, or other illicit finance activities and to achieve and monitor compliance with the applicable provisions of the BSA and other existing Treasury regulations that apply to the same risk. Because mutual funds have their own BSA requirement, they are exempt from this provision.[4] The program would need to be approved in writing by the adviser's board of directors or trustees, as applicable. Required elements include:
    - Policies, procedures, and internal controls
    - Independent compliance testing to be conducted by company personnel or a qualified outside party
    - Designation of a person responsible for implementing and monitoring the operational and internal controls of the program
    - Ongoing training of appropriate personnel
    - Ongoing customer due diligence
- Report suspicious activity. Filing a SAR would not relieve an investment adviser from the responsibility of complying with any other reporting requirement imposed by the SEC.
- Maintain records of originator and beneficiary information for certain transactions.
- Apply information-sharing provisions between and among FinCEN, law enforcement agencies, and certain financial institutions.
- Implement a special due diligence requirement for correspondent and private banking accounts.

Under the proposal, FinCEN would delegate examination authority for this rule to the SEC.

Effective & Compliance Dates

If approved, covered investment advisers would be required to comply with the rule 12 months after the final rule's effective date. The Treasury report notes that as of July 2023, there were 15,391 RIAs with approximately $125 trillion in AUM and 5,846 ERAs, who are exempt from registering with the SEC.

> The comment period ended on April 15, 2024, and as of May 22, 2024, 56 letters were received with overall negative feedback. Industry groups requested refining which advisers should be covered and a narrower definition of customer. Many were concerned about the impacts to smaller RIAs and duplicative compliance obligations.

[2]Investment advisers generally must register with the SEC if they have more than $110 million in assets under management (AUM).
[3]ERAs are investment advisers that advise only private funds and have less than $150 million in AUM in the U.S. or advise only venture capital funds. ERAs are exempt from SEC registration but still must file certain information with the SEC on Form ADV.
[4]Mutual funds are defined as open-end registered investment companies, which should include exchange-traded funds that are registered as open-end companies.

Customer Identification Programs (CIPs)

On May 13, 2024, the SEC and FinCEN issued a joint proposal to apply CIP obligations to RIAs and ERAs by having them implement a CIP that includes procedures for verifying the identity of each customer to the extent reasonable and practicable for their respective sizes and businesses within a reasonable time before or after the customer's account is opened. The procedures would have to enable the RIA and ERA to form a reasonable belief that it knows the true identity of each customer. RIAs and ERAs would be required to obtain certain identifying information with respect to each customer, such as the customer's name, date of birth or date of formation, address, and identification number. In assessing risk factors, investment advisers also would be required to determine whether other identifying information is necessary to enable the investment adviser to form a reasonable belief that it knows the true identity of each customer. Advisers also would be required to maintain records of the information used to verify a customer's identity, including name, address, and other identifying information.

> The verification time may depend on the type of account opened, whether the customer opens the account in person, and the type of identifying information available. For example, an investment adviser may choose to place limits on the account, such as temporarily limiting advisory-related activities in an account until the customer's identity is verified, in which case the adviser should inform the account holder.

Lack of Verification

An investment adviser's CIP must include procedures for responding to circumstances in which the investment adviser cannot form a reasonable belief that it knows a customer's true identity. These procedures should describe:

- When the investment adviser should not open an account.
- The terms under which the investment adviser may provide advisory services to the customer while the investment adviser attempts to verify the customer's identity.
- When the investment adviser should close an account after attempts to verify a customer's identity fail.
- When the investment adviser should file a SAR in accordance with applicable law and regulation.

Some investment advisers already obtain and conduct verification of customer identity information. For example, some investment advisers may implement CIP requirements if the entity also is a registered broker-dealer or a bank, *i.e.*, a dual registrant, or is an operating subsidiary of a bank; other investment advisers are affiliates of banks or broker- dealers, which may implement an enterprise-wide AML/CFT program that includes a CIP. Some investment advisers have already implemented voluntary AML/CFT programs that may include CIP measures.

Customer

The proposal defines a customer as a natural person or a legal entity who opens a new account with an investment adviser. An investment adviser would not be required to look through a trust or similar account to its beneficiaries and would only be required to verify the identity of the named account holder. The customer definition would not include individuals with authority or control over the accounts if such persons are not the account holders. The customer definition does not include a financial institution regulated by a federal functional regulator or a bank regulated by a state bank regulator; certain government entities; certain persons (other than banks) that are publicly listed on U.S. securities exchanges or certain subsidiaries of persons listed on U.S. securities exchanges; or persons who have an existing account with the investment adviser, provided the investment adviser has a reasonable belief that it knows the true identity of the person. These exemptions are being included to be consistent with CIP requirements for other financial institutions.

The proposal is generally consistent with the CIP requirements for other financial institutions, such as brokers or dealers and mutual funds, and are designed to align with the CIP requirements across these financial institutions.

Effective & Compliance Dates

If a final rule is approved, the effective date will be 60 days after **Federal Register** publication. The compliance date would be six months after the effective date, but no sooner than the compliance date of the AML/CFT Program and SAR Proposed Rule, if adopted.

Comments are due 60 days after **Federal Register** publication.

Conclusion

The asset management team at Forvis Mazars has more than 50 years of experience providing accounting, tax, and consulting services to various types of investment holdings, including conventional debt and equity investments, loans, businesses, alternative investments, and other unique assets. As of June 2023, Convergence Optimal Performance ranked Forvis Mazars as a top 20 accounting and audit firm to RIAs and ranked in the top 20 by AUM. We have experience providing services to funds ranging from emerging managers to $100-plus billion in AUM. Our knowledge allows us to provide tailored services to help meet your unique needs. We provide services to private, public, and Cayman funds. For more information, visit forvismazars.us.

Contributors

Brian Matlock
Partner/Financial Services
National Asset Management Leader
brian.matlock@us.forvismazars.com

Anne Coughlan
Director
anne.coughlan@us.forvismazars.com